I :Stanford U. S-4, 5 1956 AF 16 SW China
AF16

Annex "A," Subparagraph 3c,
Economic Background

BUDGET AND TAXATION

I. THE NATIONAL FISCAL SYSTEM

652 Since Communist China is a unitary state, its fiscal policy is national in scope and has relatively few regional variations. Accordingly, unless otherwise indicated, what is said here of one region is often equally true in the other regions.

From the data shown in the tabulation below, certain facts are obvious.

1. During 1950-54, the revenue derived from the profit of government enterprises rose steadily from 12.76 per cent of the total government receipt in 1950 to 36.47 per cent in 1954. Moreover, profit is not the only contribution that government enterprises made to the government treasury. In the course of these years, they also contributed an increasingly large share of taxes which the People's Republic of China (the Communist government) imposed upon industries and trade. This tendency is clearly shown in the following statistics.

1:Stanford U. S-4, 5 1956 AF 16 SW China
AF16

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SOURCES OF GOVERNMENT RECEIPTS */

Year	Government-owned Enterprises	Government-participating Enterprises	Co-operatives (combined)		Farmers	Private Industries and Trade
1950	-	-	34.08	-	29.63	32.93
1951	-	-	49.35	-	18.17	28.66
1952	-	-	56.33	-	17.08	22.36
1953	-	-	59.79	-	14.56	17.02
1954	65.24	3.65	-	1.66	14.23	13.34
1955	69.47	3.65	-	1.98	11.76	10.70

*/ [In percentage of the total annual receipt of the current year.] Economic Weekly, Feb. 26, 1953, p. 17; People's Daily, June 18, 1954; July 10, 1955. The figures for 1955 are budgetary estimates.

1:Stanford U. S-4, 5 1956 AF 16 SW China AF16

652 Unlike the usual concept used in Western countries, the profits of government-owned concerns and enterprises in which the government participates as listed in fiscal reports of the Communist government include allowances for depreciation of assets, which according to Western practice should not be included in net profit. At the same time, all the outlays of government enterprises for improvement and replacement are listed as government expenditures for economic construction. The procedure used by the Chinese Communists means, therefore, a substantial increase in both government receipts from its enterprises and outlays for economic construction.

2. During the five-year period ending 1954, the relative importance of the agricultural tax has been substantially reduced. In 1950, it accounted for 28.01 per cent of the total government expenditure. In 1954, the percentage declined to 13.33 per cent. The decrease was due to the rapid expansion of receipts from other sources (particularly profits from government enterprises and urban taxes) rather than to the reduction in the agricultural tax itself. This development therefore should be interpreted to mean that the tax on rural economy has not been reduced; it reflects merely that the increase of the agricultural tax has not been as rapid as the increase of other government receipts.

3. Similarly, the fact that the ratio of the taxes on industry and trade to the total government expenditure remained almost constant during these years should not be interpreted to mean a constant tax burden imposed on these sectors of the Chinese economy. In absolute terms, their contributions have continually increased in order to meet the ever-expanding expenditure of the government.

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As a whole, the fiscal policy of the Communist government has been more unfavorable to industry and trade than to agriculture. During the five-year period under consideration, private enterprise in industry and trade not only has had to bear a great burden of the increasing expenditure of the government, but also has been forced to accept stiff competition from government enterprises which, according to the Communist policy, will ultimately monopolize all the important trade and industries in the country. 652

On the expenditure side, military outlay constituted 41.5 per cent of total government expenditure in 1950 and 1951, respectively. After 1952, because of the truce in Korea, the relative importance of the military outlay has been substantially reduced. In 1954, it was only 21.1 per cent of the year's total expenditure. The outlay for economic construction has become the leading item on the debit side of the government account. 652 659

In making these comparisons, several observations should be noted. First, the military expenditures as listed in the records of the Communist government do not include salaries and maintenance of military personnel, which are classified as government administrative expenses. Military outlays listed in the budgets of the Nationalist Government, on the other hand, consisted mainly of such salary and maintenance payments. If the definition of military expenditure were broadened to include such outlays, and if one-half of the administrative expenses listed in the Communist budget were for the payment of military personnel and administration, then the military expenditure of the Communist government would have been tabulated here for the years 1950-52.

1:Stanford U. S-4, 5 1956 AF 16 SW China AF16

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Year	Ratio of Military Expenditure to Total Gov't Expenditure
1950	51.11
1951	49.83
1952	32.15
1953	29.45 (budget estimate)
1954	30.06
1955	32.98 (budget estimate)

In the fiscal report for 1953 the military and government administration expenditures were listed as a single item. It is rather difficult to separate the military from the non-military outlays on the basis mentioned above. For this reason, the budgetary estimates, where these outlays were separately listed, were used in this tabulation.

A second point which should be noted concerning the military expenditure of the Communist government is that a part of its expenditure for economic construction might well be considered military rather than economic. In the budget of the Nationalist Government, for example, outlays for development of aircraft-manufacturing industries, ammunition industries, and so forth were usually classified as military expenses, whereas they would probably be considered as economic outlay in the Communists' report.

A third point to be noted is that, if the depreciation charges and outlays for maintenance and replacement in government enterprises were excluded from government receipt and expenditure, as should normally be the case, the relative importance of military expenditure for the years under consideration would have been much greater than those shown in the fiscal reports.

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Even allowing for these adjustments, the fact that government outlays for economic, social, and educational purposes has been substantially increased under the Communist regime is obvious when compared with the conditions under the Nationalist Government. Whether these expenditures have actually contributed to improving the economic and social welfare of the people is, of course, another question entirely. 652

1:Stanford U. S-4, 5 1956 AF 16 SW China AF/G

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EXPENDITURES AND RECEIPTS OF THE PEOPLE'S REPUBLIC OF CHINA

(Per cent)

	1950	1951	1952	1953	1954
Expenditures					
Military	41.50	42.52	26.23	--	24.19
Government administration	19.21	14.71	11.83	44.62	11.74
Other	2.64	2.01	3.49		
Economic construction	25.51	29.50	44.79	40.38	52.07
Cultural construction	11.11	11.26	13.66	15.00	12.00
Receipts					
Agricultural tax	28.01	18.24	15.69	14.90	13.33
Taxes: industry & commerce	43.84	49.16	42.28	43.43	36.46
Receipts from gov't enterprises	12.76	25.64	28.55	35.40	40.49
Income: credit and insurance	4.87	4.79	1.53	3.00	1.26
Other	--	--	--	14.41	--

*/ Compiled on basis of actual government outlays and receipts as given in fiscal reports of People's Republic of China.

1: Stanford U. S-4, 5 1956 AF 16 SW China AF16

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In the discussion that follows, we shall examine at length some phases of Communist China's fiscal policy during the first five years of occupation of Mainland China. They include the agricultural tax, the taxation on commerce and industry, and government bonds. As will be seen, the revenues discussed are all recurrent in nature. No attempt is made to study such non-recurrent levies as those imposed during the Five-Anti Campaign. Because of the nature of these impositions, it is not likely that these measures can be successfully repeated in the near future.

II. URBAN TAXATION

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In Communist China, the core of urban taxation has consisted of the business tax, the tax on business income, and the commodity taxes.

None of the trio is new in China. Under the Nationalist Government, the business tax was collected as a local tax, the tax on business income was a part of the income tax system, and the commodity tax constituted one of the main revenues of the Nationalist Government.

Under the Communist government, all these taxes were drastically reorganized, apparently under the influence of the Russian tax system. From 1949 to date, the system of urban taxation has already undergone several important changes. Its history which may be divided into two stages, covers the period from January 1950 to December 1952.

During the first period, the industrial and commercial tax constituted the greater part of urban taxation.

651 for under the system they have to bear not only the tax but also the cost involved in transporting the tax-in-kind to designated points where the commodities are assembled by the government.

4. The agricultural tax is assessed on the basis of the gross income, taking little or not account of the cost involved in production. The system, if strictly enforced, will necessarily result in discouraging such improvements as the use of chemical fertilizers, the use of irrigation system, etc. Chemical fertilizers have been more commonly used in many parts of Central-South China than in other parts of the country. Failure to allow for such costs of production in the tax system will necessarily mean a discouragement to those who are making such improvements in their production.

5. In assessing the agricultural tax both for the regions with land reform and for the areas without land reform, the tax rates progress on the basis of the total income rather than by bracket. This could mean in some cases a payment of more tax by a taxpayer with less income than by one with more income.

IV. GOVERNMENT BONDS

652 This quota is equivalent to less than one-sixth of the subscriptions of East China, or less than one-half of the subscriptions of North China. In 1950, Victory Bonds valued at 100 million fen (one fen or unit was worth approximately US$.75) were issued; 7 per cent were allocated for subscription in Southwest China.

453 were rapidly established in Kunming. Thus, an unprecedented banking boom took place in Southwest China which vastly expanded all banking facilities. At the end of the war, there were 866 banks (including head offices and branches) in Szechwan, 149 in Yunnan, 91 in Kweichow, and 44 in Sikang.

With the surrender of Japan, the Nationalist Government re-established its capital at Nanking, the head offices of the government banks returned to Shanghai, and much of the war-inspired industrial and commercial activity in the Southwest Region was discontinued. What business remained was insufficient to support the expanded banking facilities in the region. The Shanghai banks recalled their funds, and private capital migrated to Shanghai, where increasing inflation provided a wider scope for speculative activities. Most of the local commercial banks in Szechwan and Yunnan, partly owned by the warlords, encountered difficulties because their funds were tied up in local enterprises which were adversely affected by the end of the war. As a result, the banking structure in Southwest China was reduced to impotency before the arrival of the Communists.

B. Communist Transformation

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453 When the Communists took over Southwest

453 China, they closed the branches of the Central
652 Bank of China and the Farmers' Bank, and instituted rigid supervision over the branches of the Bank of China and Bank of Communications. The new regime also took over the provincial banks outright. The regulations governing private banks which had been enforced in other regions were put into effect; the stipulations regarding the banks' operations and interest rates, the amount of reserves to be kept with the People's Bank, and the periodic reports required were so harsh that few banks could survive. The banking shares owned by so-called "bureaucratic capitalists" and "reactionaries" were confiscated. Nearly all native banks and the minor locally registered commercial banks discontinued operations because of their inability to increase capital as required; a few locally registered commercial banks in Chungking and Kunming were liquidated after their shares had been confiscated by the government and their financial resources had proved inadequate.

In May 1951, the Young Brothers Banking Corporation and the Ho Chen Bank were "advised" to join the first system of eleven banks operated jointly by state and private enterprise with headquarters at Shanghai. Both the commercial banks were owned by Szechwen capital and did business within and outside

453 the province. The Ho Chen Bank was the
652 younger of the two institutions but had made great strides during the war. As a result of a Communist-induced merger of all private banks in December 1952, the names of Ho Chen and Young Brothers disappeared from the banking world.

Meanwhile, the Bank of China and the Bank of Communications were reorganized and placed under the control of the People's Bank. With the transformation of the modern commercial banks in Shanghai into one Joint State-Private Bank, their branches in Southwest China underwent similar changes.

Before the war, a branch of the Banque de l'Indochine in Kunming was the only foreign bank in Southwest China. It ceased operation soon after the Communists took over Yunnan. The Hongkong and Shanghai Banking Corporation had established an office in Chungking during the war but withdrew soon after its end. Therefore, the Communists were hardly confronted with a problem of eliminating foreign banking influence in the region.

Since Szechwan was the most fertile of the Southwest China provinces, it had a larger number of affluent landowners and a greater amount of outstanding rural credit

1:Stanford U. S-4, 5 1956 AF16 SW China
AF16

extended by landowners than had Yunnan and Kweichow. On the other hand, pawnshops in the latter two provinces did more business than their counterparts in Szechwan, which were often handicapped by inflation and the consequent need to charge excessive interest rates.

These two sources of credit were wiped out by the Communists: the Land Reform Movement eliminated the landlords; and the pawnshops closed because they could no longer obtain bank credit nor meet the increased capital requirements established by Communist regulations.

The fragile banking structure of Southwest China could offer little resistance to Communist designs, and it was completely transformed by the middle of 1951. As the old banking structure was liquidated, the new banking system in Southwest China was developed after the general pattern of the banking system of Communist China as a whole: monolithic and uniform. It now consists of branches of the following institutions: (1) People's Bank of China; (2) Bank of China; (3) Bank of Communications; (4) Chinese People's Construction Bank; (5) Agricultural Bank of China; (6) State-Private Joint Bank; (7) Chinese People's Insurance Company; and (8) credit co-operatives.

1;Stanford U. S-4, 5 1956 AF16 SW China
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II. THE COMMUNIST BANKING SYSTEM

A. The People's Bank of China

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G52 The People's Bank of China is the supreme financial organ in the country; all other banks operate under its control. A Southwest China regional office of the People's Bank was established at Chungking as the highest authority on monetary matters and administration; branch offices were maintained in each province. The regional office was abolished with the abandonment of the regional administrative system in September 1954; the branch offices in each province were placed under the direct control of the head office at Peking and charged with the responsibility for monetary affairs at the local level.

The number of branches, one in each provincial capital, was reduced from four to three after the province of Sikang was amalgamated with Szechwan Province in October 1955. Branch offices of the People's Bank in the Southwest Region are currently located at Chengtu, Kweiyang, and Kunming.

Under each branch office there are sub-branch offices in counties, cities, and towns.

1:Stanford U. S-4, 5 1956 AF16 SW China
~~AF16~~ AF16

453 There also are temporary units, called
652 central sub-branch offices, set up at political
● or communication centers to supervise sub-branch offices in the vicinity. A network of subordinate offices called agencies, sub-agencies and stations, has been established to serve main thoroughfares and residential sections in large cities and individual towns, populous villages, schools, factories, and military posts. These offices handle deposits, remittances, and the extension of rural credits.

According to incomplete statistics there are about 400 sub-branch offices and about forty central sub-branch offices in the three provinces of Southwest China, besides several thousand agencies and stations. The total number of subsidiary offices of the People's Bank was officially reported to be more than 19,000 in March 1955.

The branch offices perform the following functions.[1] (1) Adjust the circulation of currency; (2) Act as agents for the state treasury; (3) Accept current accounts and promote savings; (4) Extend credits to

1. Kuo-min Ching-chi Shih-yung Tz'u-tien [Popular Dictionary of Practical Economics], Shanghai, Ch'un-ming Shu-tien, 1953, p. 8,013.

1;Stanford U, S-4, 5 1956 AF16 SW China
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453 industry and commerce, both public and
652 private, either directly or through affiliated banks; (5) Handle clearings of bills and transfers of accounts, and facilitate remittances; (6) Extend rural credits either through their own agencies or through co-operatives; (7) Look after receipts and disbursements of foreign exchange handled by affiliated banks; and (8) Handle any other monetary matters within their jurisdictions.

Each branch office has departments to control currency, credit to public and private enterprises, rural credits, and the promotion of savings deposits and the expansion of credit co-operatives.

B. Bank of China

The Bank of China, established as a central bank in 1912, was reorganized in 1928 as a special institution with government participation for dealing with foreign trade. After the Communists overran China, the bank was allowed to continue its old status, and those of its directors who represented private interests retained their positions. At the same time, the general manager and the directors representing Nationalist Government interests were replaced by Communist appointees; one of the newly appointed directors,

1:Stanford U. S-4, 5 1956 AF16 SW China
~~AF16~~ AF16

453 652 the director-general of the People's Bank, was concurrently nominated chairman of the board. At the first shareholders' meeting, held in November 1954 under the Communist regime, the old directors representing private interest who had left the Mainland were replaced by shareholders who were co-operating with the Communists. Hence, the Bank of China is fully controlled by the Communist government and is virtually a subsidiary of the People's Bank.

The Bank of China is entrusted by the People's Bank to:[2] (1) Administer the control of foreign exchange; (2) Handle foreign exchange, foreign securities, bills of exchange, and other commercial documents, payable or receivable in foreign exchange; (3) Extend credits, and accept deposits in connection with foreign trade; (4) Look after the accounts and clearings of foreign trade conducted by and through government organizations; and (5) Control overseas remittances.

Before 1937, the Bank of China had had only three branches in the Southwest Region,

2. Ching-chi Chou-pao [Economic Weekly], Shanghai, No. 31.

1:Stanford U, S-4, 5 1956 AF16 SW China
~~AF15~~ AF16

453 all in Szechwan. During the war the bank not
652 only increased its branches in Szechwan, but also opened a number of offices in Kweichow and Yunnan. The bank now has only two branches in Southwest China, both in Yunnan, one at Kunming and the other at Wan-ting on the Burma border.

The Communists found the Bank of China a valuable institution because of its solid reputation, core of trained personnel, and assets located in China and abroad. However, the Communist regime was able to control only 11 of the overseas branches -- in Hong Kong, London, Singapore, Penang, Kuala Lumpur, Calcutta, Bombay, Karachi, Chittagong, Rangoon and Djakarta. The other eight branches -- in South Indochina, Cambodia, Thailand, Japan, the United States, Cuba and Australia -- are still under the control of the Bank of China in Formosa because those countries have not recognized Communist China.

C. Bank of Communications

The Bank of Communications, inaugurated in 1907 as a treasury agent of the Ministry of Posts and Communications, was reorganized in 1928 with the participation of government interests as a special institution to develop industry and internal trade. In June 1951,

453 after a short period of suspension ordered by
652 the Communists, the bank was allowed to
● resume business under its old status. Probably, this was done with the intent of facilitating Communist penetration of private industries through the bank's connections. Business was resumed only after Communists were appointed to the offices of chairman of the board and general manager, and after Nationalist Government directors were replaced by appointees of the new regime. At the shareholders meeting held in December 1954, the shareholders were "advised" to elect as directors representing private interests a slate of candidates drawn up by the Communists.

The Bank of Communications performs the following functions:[3] (1) Handles appropriations for basic government construction, and screen and approve applications for appropriations for such construction; (2) Organizes and lead long-term investment markets; (3) Controls ownership rights for public shares of enterprises operated by state-private joint interests; (4) Handles long-term credits.

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3. Cheng Chu-yüan, Monetary Affairs of Communist China, Hong Kong, The Union Research Institute, 1954, p. 25.

1:Stanford U. S-4, 5 1956 AF16 SW China
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652 Since the establishment of the Chinese People's Construction Bank, it has been entrusted with the important function of handling appropriations for basic government construction. No investment markets could be created because any savable income the people might have was constantly drained by the government's frequent levies. The function of controlling ownership rights for public shares is non-existent since in every joint state-private enterprise one or more Communist appointees participates in the management, assisted by Communist-controlled labor union members. Therefore, the duties of the Bank of Communications are confined to looking after long-term credits to state-private joint industry.

The Bank of Communications increased the number of its branches in Southwest China after resuming business. The important ones are: in Szechwan Province -- Chungking, Chengtu, Neikiang, Tzeliutsing, Luhsien, and Kikiang; in Kweichow Province -- Kweiyang, Tuyun, and Tuhsan; in Yunnan Province -- Kunming and Kokui.

D. Chinese People's Construction Bank

In order to facilitate progress of the Five-Year Plan and to overcome defects in

1:Stanford U. S-4, 5 1956 AF16 SW China
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652 the appropriation of funds for capital construction, the Chinese People's Construction Bank was established in October 1954 and entrusted with the following functions:[4] (1) To handle the funds of basic construction projects, either as provided by budget appropriations or as raised by the projects themselves; (2) Supply short-term credits, according to the governments' credit plan, to the contracting organizations undertaking work on projects; (3) Settle accounts and make returns in connection with the governments' appropriations for the projects; and (4) Supervise the use of funds appropriated or raised, the arrangement of payment to contracting organizations, and project matters related to finance, cost accounting, and investments.

As soon as the head office of the Chinese People's Construction Bank was installed in Peking, branch offices were set up in places where basic construction projects were underway. A part of the buildings of the People's Bank or of the Bank of Communications

4. New China News Agency release, Peking, Sept. 13, 1954.

1;Stanford U. S-4, 5 1956 AF16 SW China
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453 were used as Construction Bank offices; a
652 number of staff members of the two older banks
● were switched to the new bank. In light of its functions and of the establishment of its branches in such a summary manner, the Chinese People's Construction Bank bears more resemblance to a government department than to a banking institution.

Less than three months after the Bank's establishment, a conference of managers of branches was held to review their work in appropriating and supervising funds for capital construction in 1954. Among the resolutions of this conference was an ambitious proposal. The Bank would supervise construction units and enterprises to fully develop the resources and potentials of each project, and would urge them to deliver profits, depreciations funds, and surplus revolving funds to upper levels on schedule.

E. Agricultural Bank of China

The Agricultural Bank of China was inaugurated on March 25, 1955. Rural finance until then had been handled entirely by the branch and subsidiary offices of the People's Bank in line with the policy of avoiding the duplication of banking services involving small

1:Stanford U. S-4, 5 1956 AF16 SW China
~~AF15~~ AF16

453 652 *loans and deposits at the local level.* As early as May 1951, a departure from this policy was contemplated when a national rural finance conference decided an agricultural co-operative bank should be set up to handle rural finance exclusively. This decision was not implemented, however, because it was contradictory to the policy of the People's Bank. The revival of the idea of creating a special rural finance institution was the result of a new call for more "co-operativization" of agriculture, and of the rapid growth of the number of credit co-operatives.

The Agricultural Bank of China performs the following functions:[5] (1) Extends long-term and short-term credits to individual producers and to joint state-private operated agricultural, stock-raising, fishery, and producer mutual-aid and co-operative organizations; (2) Handles capital investments allocated in the state budget for agriculture, forestry, and water conservation; (3) Guides and helps the people's credit co-operative organizations; and (4) Provides savings deposit services for rural residents, producer mutual-aid and co-operative organizations, collective farms, and state agriculture and water conservation organs.

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5. Ibid., March 25, 1955.

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652 At present, the function of handling capital investments appropriated in the state budget will be retained by the People's Bank, according to an official statement. Moreover, there is no indication that the new bank will develop an extended branch network on the order of the Chinese People's Construction Bank. Therefore, the present function of the Agricultural Bank of China appears to be primarily the guidance and supervision of credit co-operatives and the promotion of savings deposits in rural areas; its organization is, in reality, similar to that of a department of the People's Bank, except that the Agricultural Bank has more responsibility and discretionary power.

F. Joint State-Private Bank

Soon after all banks in Shanghai had been transformed into joint state-private concerns and then grouped, with the exception of the Shanghai Commercial and Savings Bank, into four joint management units, they were all "advised" to merge into one Joint State-Private Bank. It began operations on January 1, 1953. Only two Szechwan banks, the Young Brothers Banking Corporation and the Ho Chen Bank, were involved in the merger. The general managers of the two Szechwan banks were included on the 103-man boards of directors

1:Stanford U. S-4, 5 1956 AF16 SW China
AF16

453 of the joint bank and made two of its 27 managing
652 directors. The Chungking, Chengtu, and Kunming branches of the component banks in the merger were ordered amalgamated in each city into one branch of the Joint State-Private Bank; branches of the component banks in other cities of Southwest China were closed. The amalgamated branches in Chungking, Kunming, and Chengtu constitute three of the thirteen branches of the joint bank maintained throughout the country; the head office is located in Peking.

The chairman of the board and the chief manager of the bank are appointees of the People's Bank, which completely controls the Joint State-Private Bank. The Joint Bank is empowered to fulfill the following functions:[6] (1) Handle accounts of private enterprises; (2) Extend short-term credits to private enterprises, subject to the advice of the People's Bank; (3) Handle inland remittances and overseas Chinese remittances through the branches of component banks still operating in Hong Kong for the account of the Bank of China; and (4) Accept savings deposits for the account of the People's Bank.

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6. Report of Shanghai Commercial Bank, Hong Kong.

1:Stanford U. S-4, 5 1956 AF16 SW China
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453 652 The Hong Kong branches of the Young Brothers Banking Corporation and of the Ho Chen Bank are still allowed to operate. Other Hong Kong branches of the component banks which likewise continue to function are: Kincheng Banking Corporation, Yieh Yieh Commercial Bank, China and South Sea Bank, Sin Hwa Savings Bank, the China State Bank, the National Commercial Bank, and the National Industrial Bank. The desire of the Communists to maintain as many interests in Hong Kong as possible accounts for the continued operation of these branches, in spite of their handling only small deposits and remittances.

G. Credit Co-operatives

452 474 Credit co-operatives in rural areas have experienced tremendous growth since 1954. The number throughout the country increased from about 13,000 at the end of 1953 to 153,400 in June 1955.[7] According to Communist statistics, credit co-operatives exist in about 80 per cent of the more than 2,000 counties in the country and have a membership of nearly 100,000,000.

7. Ta-kung Pao, Tientsin, Oct. 6, 1955.

456 Since 1950, the Chinese People's Insurance Company has handled the compulsory insurance of assets of state-owned enterprises and supply-marketing co-operatives above the county level and of persons traveling by rail, steamer, and aircraft. The company also has promoted life and private property insurance on a voluntary basis in urban centers. Insurance of livestock and farm crops has been encouraged in rural areas. Rates for various categories of insurance have been reduced, and the scope of coverage broadened. However frequent criticism of the company has been expressed concerning imprudent expansion, inexperienced personnel, and the arbitrary attitude displayed by the officers.

III. BANKING OPERATIONS

453 652 The operation of these varied banking and financial organizations is integrated through their subordination to the single command of the People's Bank, and, in effect, they operate as a single body. During the development of the Communist monetary system, the emphasis of the whole banking operation appears to have shifted. At its inception, popularization of the People's Bank notes and the promotion of individual deposits were stressed; at a later stage, control of cash funds held by public organizations and centralization of credit extension were emphasized; recently,

453 attention is being focused on attracting peasants'
452 deposits. But the main objective of these different emphases is to subject all economic activity to state direction by controlling all cash funds held by organizations, firms, and individuals, and by completely controlling the distribution of credit.

A. Cash Control

Beginning in March 1950, control over revenue collections was enforced; all government agencies handling such funds are required to deposit them with the People's Bank or its authorized agencies. Similar control was soon extended over funds held by publicly operated enterprises, the armed forces, and co-operatives. These organizations are allowed to keep on hand only small, stipulated amounts of cash and are required to make all payments by check, except for wages, salaries, and the purchase of local products in rural areas.

After intensification of the Korean war in 1951, the increasing fluctuation of commodity prices and the revival of black-market financial dealings prompted the Communists to further tighten control over cash held by private firms and individuals. All persons engaged in business are required to deposit the day's net proceeds in their bank

1:Stanford U. S-4, 5 1956 AF16 SW China
~~AF16~~ AF16

453 accounts; all shops have to make their pur-
652 chase payments by check, and under no circumstances can cash be used. Checks received for the sale of goods have to be deposited in bank accounts; under no circumstances may these checks be used to buy other goods. All persons are required to bank their cash holdings in excess of PB$2,000,000 (about US$80.00);[10] all firms and individuals must use checks for transactions exceeding PB$100,000 (about US$4.00).

To prevent the use or retention of checks as substitutes for cash, "crossed checks" (checks so marked that they cannot be cashed, but only deposited to the account of the payee) are mandatory in transactions between public enterprises, and special checks in transactions between public and private enterprises. To preclude the acquisition of cash by transferring funds from one locality to another, such transactions can only be accomplished by the use of "crossed checks"; and the paying bank is responsible for validating the transfer.

A lucrative rate of interest of 5.4 per cent a year was paid on current accounts

10. Cheng, op. cit., p. 84.

1;Stanford U. S-4, 5 1956 AF16 SW China
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453 opened by private enterprises or individuals
652 until October 3, 1955. On that date, it was reduced to 2.88 per cent to "implement the strict practice of economy".[11] Indeed cash control has been so effective that the inducement of high interest is no longer necessary to encourage the banking of excess cash.

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652 The People's Bank also vigorously encouraged saving. Many subordinate offices were established for this express purpose, and their officers visited residents in the vicinity to solicit deposits. In rural areas, quotas for increasing savings deposits were set for each county, which, in turn, fixed quotas for each village and household. After the enforcement of the state plan for the unified and compulsory purchase of grain, cotton, and oil-bearing crops, canvassing for rural savings by banks in conjunction with credit co-operatives was accentuated with the hope of absorbing the purchase proceeds into the bank. It is interesting to note that the People's Bank, at the time it issued the new currency in March 1955, provided in its Savings Deposits Regulations for maintaining secrecy concerning depositors and their funds. The bank

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11. New China News Agency release, Peking, Oct. 3, 1955.

1:Stanford U. S-4, 5 1956 AF16 SW China
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and its agencies became responsible for guarding in closest secrecy the names, addresses, specimens of signatures and seals, amounts of deposits, identities of depositors, and particulars on the receipt or payment of money for savings depositors. This indicates the extent to which the Communists were prepared to go to induce deposits.

According to a Communist report, bank deposits in China's cities at the end of August 1955 amounted to more than 1,440 million yuan (over US$576 million) mostly in fixed deposits. There was no explanation as to whether the fixed deposits included savings deposits. The number of depositors in the seven major cities of Peking, Tientsin, Shanghai, Wuhan, Canton, Chungking, and Sian was reported to have been 4.8 times higher in the first six months of 1955 than in the same period of 1954.[12] One report shows that savings deposits in the third quarter of 1954 amounted to 610 billion yuan (old currency; about US$24.4 million) in Szechwan[13] and 216 billion yuan (old currency, about US$8.6 million) in Yunnan.[14] Per capita savings in Szechwan (population 62,303,999) amounted to

12. Ibid.,
13. Ta-kung Pao, Tientsin, Oct. 19, 1954.
14. Ibid., July 27, 1954.

452 US$0.40 and in Yunnan (population 17,472,737) 652 to US$0.50.

B. Credit Control

During the first years of Communist rule, when the power of granting credit was concentrated in the head office of the People's Bank at Peking, the Southwest China regional office of the bank had more power of decision on credit matters because it was remote from the financial and political capital; yet important matters had to be referred to the Financial and Economic Committee of the Greater Southwest Region Administration.

Since the adoption by the People's Bank, in 1953, of a decentralization policy on credit extension, followed by the abolition of the Greater Regional Administration in 1954, the branch office of the bank in each province has had the power and responsibility to extend credits. In applying for a loan, public enterprises and co-operatives are required to provide the branch office with a budget outlining credit needs and a plan estimating the extent to which the proposed project will increase production, raise labor productivity, and lower production costs. Credits are classified according to their duration (short, long, or seasonal) and use; borrowers are required to adhere to the terms expressed in the contract.

1:Stanford U. S-4, 5 1956 AF16 SW China
~~AF16~~ AF16

453 The granting of credit to private enter-
652 prises is subject to the same requirements for furnishing a plan and a budget. Before the Communist takeover, a system of specialization in certain lines of business had been developed by each private bank; thus, one bank granted credits to textile enterprises, another to the metal industry, etc. When all private banks were merged into the Joint State-Private Bank, the latter was placed in charge of the extension of credits to private enterprises under the direction of the People's Bank. A system of joint application was promoted; enterprises in the same line of business were encouraged to apply jointly for credits, listing the financial requirements of each firm with an estimate of its production and demand for its output. This arrangement was intended to prevent "blind" competition in production and preclude the diversion of bank credit by one borrower to help another.

Extension and acceptance of credit between public enterprises and private firms were prohibited to eliminate commercial loans. Private enterprises have had to depend entirely on government banks for credit. Furthermore, an exorbitant rate of interest has been charged on credits to private enterprises: private industry paid 10.8 to 19.8 per cent annually, while private commerce was subject to rates of from 16.2 to 23.4 per cent. Though

453 the interest rate was reduced on October 3,
652 1955, it remained as high as 11.88 per cent for private industry and 16.2 per cent for private commerce,[15] double the rate charged for public industry and commerce.

The Communist regime's accession to control of rural credit through the instrument of the People's Bank seems to have been an easy task. The large-scale landlords and retail merchants, who had been the most important source of rural credit, particularly in Szechwan and Yunnan, were stripped of their wealth if not of their lives; the newly emerged rich peasants were drained of their limited funds by compulsory subscriptions to savings deposits, government bonds, and various patriotic drives. Moreover, the so-called fixed purchase of grains, cotton, and oil-bearing crops barred the peasants from accumulating any kind of savings which might be loaned.

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652 The vigorous Communist drive to increase participation in credit co-operatives aims at utilizing the peasants' own funds for the extension and control of rural credits. This

15. New China News Agency release, Peking, Oct. 3, 1955.

1;Stanford U, S-4, 5 1956 AF16 SW China
~~AF16~~ AF16

objective is indicated in a directive issued on September 12, 1955 by the head office of the People's Bank to its branches,[16] stating that branches must guide credit co-operatives in encouraging savings deposits for the use of rural credits in the coming year. The branches also were ordered to collect matured long-term credits prior to the start of government crop purchases. This directive indicates that the Communists use the withdrawal of rural credits as a weapon to force peasants to sell their products to the government.

In 1955, rural credit was extended at the following interest rates:[17]

Agricultural production co-operatives	7.2% per annum
Producer mutual-aid teams	9.0% per annum
Individual peasants	10.8% per annum
Very poor peasants	9.0% per annum

16. Peking broadcast, Sept. 12, 1955.
17. New China News Agency release, Peking, Nov. 3, 1955.

1:Stanford U. S-4, 5 1956 AF16 SW China
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IV. CURRENCY

A. Currency System

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652 After the establishment of the People's Bank of China in Shih-chia-chuang of Hopei Province on December 1, 1948, Jen-min-p'iao (People's Banknotes) were first issued. They have become the uniform currency of Communist China. They are the monetary unit for all tax payments, settlement of accounts, and computation of commodity prices. Circulation of all gold, silver, and foreign currencies has been prohibited. Since March 6, 1951, the circulation of Jen-min-p'iao has been restricted to Communist China only, and export of the notes forbidden.

The Jen-min-p'iao is not redeemable in any precious metal nor interchangeable with any foreign currency. No provision is made for limiting its issue. The Communists' rationalization of their monetary system evolved from a very primitive theory to a more advanced one. At an early stage, the Communists explained that the note issue was backed by foodstuffs and cloth. Later the regime claimed that "the increasing stability of the currency is borne out by the balance of the budget, by the balanced distribution of supplies, and by the balance of cash receipts

436 and expenditures." Recently the regime has
652 referred to other indicators of the currency's value --i.e., the balance of international payments and the resulting increase of foreign reserves. It would appear that the Communists discovered during the period of currency inflation the Chinese people's instinctive ability to distinguish between good and bad money and have had to find plausible monetary theories to quiet the people's anxiety.

The Communists have kept the amount of note issue strictly secret, yet the progress of inflation becomes evident in observing the increase of the notes' denominations. The Jen-min-p'iao was first issued in denominations of 1, 5 10, 20, 50 and 100 yuan. By the second half of 1949, the printing of notes was speeded up to cover huge government deficits. The small denomination notes were no longer found practical, and larger denominations of 200, 500 and 1,000 yuan were successively introduced. Between February and April 1950 an additional issue of 5,000 and 10,000 denomination notes was made. Finally the denomination was enlarged to 20,000 and 50,000 during 1953-54.

On March 1, 1955, a new kind of People's Banknotes in small denominations was issued,

436 and current People's Banknotes were called in.
452 The major denominations of the new currency are 1, 2, 3, 5, and 10 yuan. The smaller denominations are 1, 2, and 5 fen (100 fen equal one yuan) and 1, 2, and 5 chiao (10 chiao equal one yuan). A new one-yuan note is equivalent to 10,000 yuan note of the old currency. All old banknotes outstanding in denominations above 5,000 yuan were to be exchanged at the People's Bank before the end of April 1955, and denominations of 5,000 and less not later than June 10, 1955.

A statement made by the vice-premier and concurrent finance minister of Communist China on the issue of the new currency is worth noting. He admitted for the first time that inflation existed under the Communist regime but, ironically, heralded the new banknote issue at the rate of 1 to 10,000 of the old notes as the cure for inflation. At the same time, he revealed the true objective of the new issue by adding that it would aid considerably in accounting for the possession and use of money in China.

Although the Bank of China quotes a foreign exchange rate for the Jen-min-p'iao, the quotation does not reflect the real value of the Chinese currency in international monetary terms. Frequent revisions were made in

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436 the rate until May 1951, but since then few
652 changes have been announced. No exchange rate in terms of the American dollar have been quoted since the United States government enforced the embargo on trade with Communist China in 1950. Figures on the cross rate of the Hong Kong currency, quoted by the Communists at HK$2.34 per PB¥1, one People's Banknote is valued at US$0.385. Despite the fact that these evaluations have not been tested on the open market and that the old currency was subject to inflation, a responsible official of the People's Bank publicly announced that the new currency of China was one of the most stable in the world.[18]

B. Currency Control

The Communists found currency control in Southwest China more necessary than in other areas because the people in the region were more experienced in facing the problems of an unsound currency. For more than two decades after the establishment of the Republic in 1911, Szechwan warlords practiced all kinds of currency manipulation; they debased silver dollars, silver coins, and even copper coins, issued unbacked paper notes through local

18. Ibid., Peking, March 20, 1955.

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436 banks and private armies, and repudiated the
652 redemption of banknotes issued against real reserves. These same practices were duplicated in Yunnan on a smaller scale. As a result, the people in these provinces were always alert to protect their interests whenever monetary inflation, debasement, or manipulation occurred. The warlords had not been able to derive much revenue from debased currency and inflated notes because the people refused to accept such money.

During the inflation under the Nationalist Government from 1938 to 1949, the people of the Southwest Region tried to exchange banknotes for gold and commodities. After the Communists took over Southwest China, a fair amount of scattered gold and silver holdings was reported uncovered in the course of liquidating the landlords and local "despots" and through extortionate fines during the Three-Anti and Five-Anti movements. Frequent exactions were made on the people to prevent them from turning their cash into goods. Southwest China was allocated 15 per cent of the 1950 Victory Bond series, amounting to a nationwide total of US$70 million;[19] assigned

19. Hsin Chung-kuo Ta-shih Chi-k'an [New China Events Quarterly], No. 4, Peking, Jen-min ch'u-pan-she, 1949, p. 127.

a quota in 1951 of 8.3 per cent of the US$220 million amunition contribution for the Korean conflict;[20] and required to contribute 16 per cent of the total of US$220 million collected throughout the country during 1950 and 1952 in the Resist-America-Aid-Korea Movement.

In addition, Southwest China has been assigned a proportionate share of the Economic Construction Bonds amounting to US$250 million yearly since 1954. In 1954, 53.3 per cent of the issue was allocated to private industrial and commercial enterprises, the private partners of joint enterprises, and other city residents; 30 per cent to rural villages, and 16.6 per cent to workers, shop employees, working personnel of the government and public organs, and the cadres of the armed forces. In the 1955 allocation, the first category was reduced to 45% and the last category increased to 25%, the second category remaining the same.[21] An issue of Economic Construction Bonds for 1956 was announced in November 1955.

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20. Ho Yü-wen, Chung-kung Ts'ai-cheng Chieh-p'ou [An Analysis of Communist China's Finance], Hong Kong, Asia Press, 1953, p. 74.

21. Jin-min Jih-pao [People's Daily], Peking, Jan. 9, 1955.

436 According to an estimate[22] made by
652 the Communists in 1955, workers were required to pledge a little more than 7 yuan per head (about US$2.70) for their subscription to the Economic Construction Bonds, and the peasants, excluding those in calamity-stricken areas, were required to pledge an average of 0.4 yuan.

Since the government began the enforced purchase of grains, cotton, and oil-bearing crops, hardly any staple commodities have been left for the people to hoard, and the bond subscriptions have consumed what little cash might have been available for saving. In view of the past ingenuity of the people in the Southwest Region to defend themselves against inflation, it remains to be seen whether currency control will remain effective, and if so, how it will influence incentives for agricultural and industrial production.

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22. Ibid.